

Mbizana Municipality Audit Report

For the year ended 30 June 2013

**REPORT OF THE AUDITOR-GENERAL TO EASTERN CAPE PROVINCIAL
LEGISLATURE AND COUNCIL ON THE MBIZANA LOCAL MUNICIPALITY
REPORT ON THE FINANCIAL STATEMENTS**

Introduction

1. I have audited the financial statements of the Mbizana Local Municipality ... to ..., which comprise the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, statement of comparison of budget and actual amounts, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the requirements of the Municipality Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMFA) and the Division of Revenue Act of South Africa, 2012 (Act No. 5 of 2011) (DORA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the General Notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my adverse audit opinion.

Basis for Adverse of opinion

Property, plant and equipment (PPE)

6. The municipality did not account for its PPE in accordance with Standard of Generally Recognised Accounting Practice, GRAP 17, *Property, plant and equipment* in the following circumstances:

- Useful lives of assets were not reviewed at the end of the reporting period
- Assets that were not in appropriate working condition were not tested for impairment as required

- Depreciation was incorrectly calculated
- Assets were incorrectly classified as property plant and equipment.

Consequently, PPE as disclosed in note 2 is overstated by R33, 1 million and operating expenditure is understated by R15,2 million, non current assets held for sale is understated by R16,5 million and investment property is understated by R1,4 million.

7. In addition I was unable to obtain sufficient appropriate audit evidence for PPE due to the following matters:

- The entity did not determine the recoverable amounts of assets as required by Standard of Generally Recognised Accounting Practice, GRAP 21, *Impairment of non-cash generating assets*
- I was not provided with sufficient appropriate supporting evidence of the review at the financial year-end of the residual values as required by Standard of Generally Recognised Accounting Practice, GRAP 17
- Sufficient appropriate audit evidence for adjustments was not provided.

8. I was unable to confirm the current and comparative amount for PPE by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to property, plant & equipment of R244 million (2012: R259 million) as disclosed in note 2 to the financial statements.

Cash flow statement

9. The municipality has recognised non-cash items on the cash flow statement contrary to the requirements of Standard of Generally Recognised Accounting Practice, GRAP 2, *Cash flow statement*. Consequently, cash generated from operations is understated by R2,5 million and cash flows from investing activities are overstated by the same amount. Furthermore I was unable to obtain sufficient appropriate audit evidence for the reconciling item of prior years amount of R2,5 million (2012: R8, 3 million) in note 22 to the financial statements. I was unable to confirm the reconciling item by alternative means. Consequently I was unable to determine whether any adjustment to the cash flow statement was necessary.

Consumer debtors

10. During 2012 the municipality incorrectly recorded service revenue amounting to R3, 4 million in the incorrect accounting period. Consequently consumer debtors were understated and service charges were also understated by the same amount. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

11. The municipality could not substantiate the assumptions used in the calculation of the provision for bad debts disclosed in note 6, as required by Standard of Generally Recognised Accounting Practice (GRAP 104). I was unable to confirm the provision by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to provision for bad debts of R6, 6 million (2012: R4, 8 million).

Cash and cash equivalents

12. I was unable to obtain sufficient appropriate audit evidence for the reconciling item in the bank reconciliation. I was unable to confirm the amounts by alternative means. Consequently I was unable to determine whether any adjustments to cash and cash equivalents of R4,3 million as disclosed in note 7 were necessary.

Expenditure

13. During the current and prior period I was unable to obtain sufficient appropriate audit evidence for expenditure. I was unable to confirm the amounts by alternative means. Consequently I was unable to determine whether any adjustments to expenditure were necessary. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

14. Expenditure relating to the current period was not recorded in the accounting records at the end of the current period. Consequently expenditure is understated by an amount of R1, 7 million and creditors are understated by the same amount. I was unable to obtain sufficient appropriate audit evidence relating to payments to a supplier. I was unable to confirm the expenditure by alternative means. Consequently I was unable to determine whether any adjustments to expenditure of R37 million as disclosed in note 21 were necessary.

Unauthorised expenditure

15. The municipality did not have adequate systems in place to identify and disclose all unauthorised expenditure incurred during the year as required by section 125(2)(d) of the MFMA. Unauthorised expenditure incurred as disclosed in note 42.1 to the financial statements is understated for amounts identified during the audit process of R4, 3 million. Due to the lack of systems however, it was impracticable for me to determine the full extent of this understatement.

Irregular expenditure

16. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d) of the MFMA. Irregular expenditure incurred as disclosed in note 42.3 to the financial statements is understated for amounts identified during the audit process of R25, 9 million. Due to the lack of systems however, it was impracticable for me to determine the full extent of this understatement.

Commitments

17. The municipality did not have an adequate and complete contract management system in place for the identification and recognition of contracted commitments and did not disclose commitments as required by SA Standards of GRAP 17, *Property, Plant and Equipment*. Due to the lack of adequate systems in place, it was impracticable to determine the full extent of this understatement. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments to the commitments disclosure note were necessary.

Trade and other payables from exchange transactions

18. During the prior period, I was unable to obtain sufficient appropriate evidence for payables. I was unable to confirm the amounts by alternative means. Consequently I was unable to determine whether any adjustments to trade and other payables of R5,3 million as disclosed in note 10 were necessary. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Aggregation of immaterial uncorrected misstatements

19. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial performance and the disclosure notes to the financial statements:

- Fair value loss is overstated by R1,3 million
- Unspent conditional grants is understated by R1,7 million
- Investment property is understated by a further R1,3 million

20. I was unable to obtain sufficient appropriate audit evidence and I was unable to confirm the following elements by alternative means, or determine whether any adjustments were necessary:

- Grants and subsidies included in note 13
- Trade and other receivables from non exchanges transactions included in note 4
- Provisions included in note 9
- Trade and other payables included in note 1

Adverse opinion

21. In my opinion, because of the significance of the matters described in the Basis for adverse opinion paragraphs, the financial statements do not present fairly financial position of the municipality as at 30 June 2013 and its financial performance and cash flows for the year then ended, in accordance with SA standards of GRAP and the requirements of the MFMA and DORA.

Emphasis of matter

22. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Restatement of corresponding figures

23. As disclosed in note 37 to the financial statements, the corresponding figures for 30 June 2012 have been restated as a result of errors only discovered during the current financial year.

Additional matter

24. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited supplementary schedules

25. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

26. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

27. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.

28. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development priorities or objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information*. The reliability of the information in respect of the selected development is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

29. The material findings are as follows:

Usefulness of information

Consistency

Reported objectives and indicators not consistent with planned objectives and indicators

30. The Municipal Systems Act, section 41(c) requires that service delivery agreement should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 54% of the selected reported objectives and 77% of elected reported indicators are not consistent with the objectives and indicators as per the approved service delivery agreement. This was due to a lack of monitoring and review by management on the consistency between planning and reporting performance information.

Reported targets not consistent with planned targets

31. The Municipal Systems Act, section 41(c) requires that service delivery agreement should form the basis for the annual report, therefore requiring consistency of

objectives, indicators and targets between planning and reporting documents. A total of 100% of the selected reported targets not consistent with the targets as per the approved service delivery agreement. This was due to a lack of monitoring and review by management on the consistency between planning and reporting performance information.

Changes to objectives, indicators and targets are not approved

32. Section 25(2) of the Municipal Systems Act determines that an integrated development plan adopted by a municipal council may be amended in terms of section 34 and remains in force until an integrated development plan is adopted by the next elected council. Therefore, if the integrated development plan is changed in-year this process has to take place in accordance with the process as prescribed per section 34 of the Municipal Systems Act.

33. A total of 100% of the amended selected objectives, indicators and targets reported in the annual performance report were changed in-year without adoption by the council of the municipality. This was mainly due to the lack of controls over changes to performance information as well as inadequate policies and procedures explaining the responsibilities of management with regards to the performance management process.

Measurability

34. The National Treasury Framework for managing programme performance information requires that indicators/measures should have clear, unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 100% of the selected indicators were not well defined in that clear, unambiguous data definitions were not available. This was due to the fact that there were no documented standard operating procedures for the management of indicators. Management was aware of the requirements of the FMPP but did not receive the necessary training to enable application of the principles.

Additional matter

35. I draw attention to the matter below. My conclusion is not modified in respect of this matter:

Achievement of planned targets

36. Of the total number of 167 targets planned for the year, 92 of targets were not achieved during the year under review. This represents 56% of total planned targets that were not achieved during the year under review. This was mainly as a result of the institution not considering the existence of relevant systems, evidential requirements and appropriate baselines for targets during the annual strategic planning process.

Compliance with laws and regulations

37. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

Annual report and annual financial statements

38. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act. Material misstatements identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements resulted in an adverse audit opinion being expressed on the financial statements.

Asset management

39. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the Municipal Finance Management Act.
40. An effective system of internal control was not in place, as required by section 63(2)(c) and 96(2)(b) of the Municipal Finance Management Act.
41. The municipality did not establish an investment policy that was adopted by council, as required by section 13(2) of the Municipal Finance Management Act and Municipal investment regulation 3(1)(a).

Audit Committee

42. The audit committee was not constituted, in the manner required by section 166(4)(a) of the Municipal Finance Management Act as the audit committee did not consist of at least three persons with appropriate experience during the year under review.
43. The audit committee did not advise the council on matters relating performance management as required by section 166(2)(a) of the Municipal Finance Management Act.
44. The audit committee did not adequately respond to the council on the issues raised in the audit reports of the Auditor-General, as required by section 166(2)(c) of the Municipal Finance Management Act.

Internal Audit

45. The internal audit unit did not advise the accounting officer on matters relating to compliance with the Municipal Finance Management Act, the Division of Revenue Act and other applicable legislation, as required by section 165(2)(b)(vii) of the Municipal Finance Management Act.
46. The internal audit unit did not function as required by section 165(2) of the Municipal Finance Management Act, in that:

- a risk-based audit plan was prepared late as the service provider was appointed late in the year under review.

Conditional grants received

47. The municipality did not evaluate its performance in respect of programmes funded by the Integrated National Electrification Programme (Municipal) Grant and submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the Division of Revenue Act.
48. The municipality did not submit quarterly performance reports to the transferring

national officer, the relevant provincial treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of the Division of Revenue Act.

49. The municipality did not timeously submit project registration forms, for projects it intends implementing in the financial year 2013/14, to the department of local government, as required by the Division of Revenue Grant Framework, Gazette No.35399.

50. The municipality did not submit project implementation plans to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No.35399.

51. The municipality did not evaluate its performance in respect of programmes funded by the Financial Management Grant and submit the evaluation to the transferring national office within two months after the end of the financial year, as required by section 12(5) of the Division of Revenue Act.

52. Unspent conditional grant funds were not surrendered to National Revenue Fund, as required by section 21(1) of the Division of Revenue Act.

Revenue management

53. A tariff policy was not implemented for the levying of fees for provision of municipal services, as required by section 74(1) of the Municipal Systems Act and section 62(1)(f)(i) of Municipal Finance Management Act.

54. An adequate management, accounting and information system which accounts for revenue was not in place, as required by section 64(2)(e) of the Municipal Finance Management Act.

55. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the Municipal Finance Management Act.

Liability management

56. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the Municipal Finance Management Act.

Consequences management

57. The municipal council did not investigate all instances of irregular expenditure, unauthorised expenditure and fruitless and wasteful expenditure to determine if any person is liable for the expenditure, as required by section 32 of the MFMA.

Strategic planning and performance management

58. The municipality did not afford the local community at least 21 days to comment on the final draft of its integrated development plan before the plan was submitted to council for adoption, as required by Municipal planning and performance management regulation 15 (3).

59. The performance management system of the municipality did not provide for the monitoring of performance and for the measuring and review of performance at least once per year, with regard to each of those development priorities and objectives and against the key performance indicators and targets set, as required by section 41 of the Municipal Systems Act.

60. The performance management system of the municipality did not provide for taking steps to improve performance with regard to those development priorities and objectives where performance targets are not met, as required by section 41 (1)(d) of the Municipal Systems Act.
61. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the Municipal Systems Act.
62. The accounting officer of the municipality did not by 25 January assess the performance of the municipality during the first half of the financial year, as required by section 72(1) (a)(ii) of the Municipal Finance Management Act .
63. A performance audit committee was not in place and the audit committee was not used to fulfil the performance audit committee function, as required by Municipal planning and performance management regulation 14(2) (a).
64. The audit committee did not review the municipality's performance management system and/or make recommendations to the council, as required by Municipal planning and performance management regulation 14(4) (a) (iii).
65. The audit committee did not review the quarterly internal audit reports on performance measurement, as required by Municipal planning and performance management regulation 14(4) (a) (i).
66. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4) (a) (iii).
67. The internal audit did not audit the results of performance measurements, as required by section 45(1) (a) of the Municipal Systems Act and Municipal planning and performance management regulation 14(1) (a).
68. The internal audit unit did not assess the functionality of the performance management system, as required by Municipal planning and performance management regulation 14(1) (b) (i).
69. The internal audit unit did not assess the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance indicators, as required by Municipal planning and performance management regulation 14(1) (b) (iii).
70. The internal audit unit did not audit the performance measurements on a continuous basis, as required by Municipal planning and performance management regulation 14(1) (c).
71. The annual performance report for the year under review does not include the performance of the municipality external service providers as required by section 46 (1) (a) of the Municipal Systems Act.
72. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls as required by section 62(1)(c)(i) of the Municipal Finance Management Act.

Expenditure management

73. The accounting officer did not take reasonable steps to prevent irregular, unauthorised and fruitless and wasteful expenditure, as required by section 62(1) (d) of the MFMA.
74. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors and accounted for payments made, as required by section 65(2)(b) MFMA.
75. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.

Procurement and contract management

76. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).
77. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality as required by SCM regulation 27(3).
78. Contracts and quotations were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding [and quotations], in contravention of SCM Regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
79. The preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).
80. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43
81. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

Internal control

82. I considered internal control relevant to my audit of the financial statements, performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for adverse opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

83. Effectiveness of the political leadership was severely affected by the political instability that occurred during the financial year. The executive authority was not part of the municipality for a long period to have an impact on the control environment of the municipality. Adequate and sufficiently skilled resources were not in place as a result of vacancies at senior management level and the performance of municipal officials was not monitored by those charged with governance and leadership.
84. Leadership did not fulfil its oversight responsibilities with regards to the implementation and monitoring of internal controls and compliance with laws and regulations and did not

insist on daily disciplines to ensure sound financial and performance management and compliance with laws and regulations. This resulted in inaccurate, incomplete and inadequate financial and performance reporting.

Financial and performance management

85. Inadequate record management practices, poor financial discipline and inadequate monitoring controls resulted in significant deficiencies in the general control environment. Where information was available it was either often incomplete or did not support the underlying accounting records reported in the financial statements and the performance report. The municipality did not institute regular processes of collecting, collating and reporting on credible information which assisted with decision making and direction of the municipality's financial and performance objectives. As a result, sufficient appropriate audit evidence was not obtained for a number of significant components reported in the financial statements and performance report.

86. Appropriate daily and monthly processes, procedures and controls were not introduced to ensure that all transactions were accurately recorded, classified, reconciled, approved and reported on, in accordance with Generally Recognised Accounting Practice (GRAP) and the FMPP. Material misstatements across all cycles and components signified a lack of review of transactions and balances at all managerial levels within the municipality, including the inadequacy of detection systems to alert management of control failures. Officials did not always fulfil their assigned duties and responsibilities and the performance of staff was further compromised by outdated policies and procedures.

87. The lack of financial discipline and monitoring throughout the financial year resulted in a large number of reconciliations, journals and corrections being performed after year-end, mainly by consultants.

88. Leadership did not adequately monitor the actions and outputs of officials throughout the year under review to ensure compliance with key legislation such as the MFMA, DoRA and Systems and Structures Acts, as a result the majority of municipal laws and regulations were not complied with. In addition SCM compliance awareness amongst officials across all functional areas was not at the desired level, as evidenced by the abnormal amount of irregular expenditure identified during the audit.

89. The municipality did not design and implement formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information. This was further evidenced by the lack of reconciliations between IT system generated reports and amounts disclosed in the financial statements

Governance

90. Although a risk assessment was performed it was inadequate as no responsibilities or actions were assigned in terms of identified risks and as a result were not used as a mitigating tool by management. The review of financial statements and the report on predetermined objectives before submission thereof to the auditors by the audit committee was not effective as material misstatements were identified. The internal audit plan for 2012/2013 financial period was approved in June 2013 as a result projects such as the review of safeguarding of assets to address significant risks of the municipality were not performed.

OTHER REPORTS

Investigations

91. Investigations are currently being conducted by National Treasury and the Hawks due to alleged fraud on payments made to a supplier. The municipality allegedly made payments to the supplier for services that were not rendered.

Auditor - General

East London

30 November 2013



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence